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The new government gets a lesson in supply-side economics as businesses revolt against tax hikes.

POLITICAL ECONOMICS

British Labour Meets the Laffer Curve

London British Chancellor of the Exchequer Rachel Reeves is under fire for allegedly padding her résumé to say she was an economist at Halifax Bank of Scotland when she was in fact only a junior banker. But perhaps Ms. Reeves can now claim credit for one major economics research finding: She's revealing the limit past which it's impossible to tax the United Kingdom.

Behold the all-fronts revolt since Ms. Reeves last month delivered the new Labour government's painful taxand- spend budget. If all goes according to plan, the budget would raise total government receipts (taxes plus other fees, charges and the like) to 42.4% of gross domestic product by 2030. This year's figure, 40.5%, was already the highest since the immediate aftermath of World War II. Britain can't afford it.

The rebellion against these tax hikes began with retailers and other low-profit-margin businesses, which warn of dire consequences from Ms. Reeves's plan to raise the National Insurance tax, a payroll levy that in practice serves as a second income tax to fund general government. Ms. Reeves wants to increase the employer portion to 15% from 13.8%, while lowering the income threshold at which the tax kicks in. Estimated revenue: £122 billion over five years.

The tax, which is accompanied by an increase in the minimum wage, will force companies across a wide swathe of industries to trim investment and could cost up to 100,000 jobs over the next five years, according to estimates by (actual) economist Sanjay Raja at Deutsche Bank. The Labour budget has sent companies into "crisis containment" mode, Rain Newton- Smith of the Confederation of British Industry said at that lobbying association's annual conference this week. She reported that two-thirds of the companies CBI has surveyed on the matter say they'll have to reduce investment due to the heavier tax burden. This inevitably means fewer new jobs, and lower pay for those who remain employed.

Farmers are in an uproar about another part of Ms. Reeves's budget. She aims to raise £1.8 billion over five years by reducing an exemption from inheritance tax for agricultural property. Family farms warn the measure will suppress investment and could force them to break up thriving businesses to cover death-tax bills. In protest, they brought tractors to the area around the Houses of Parliament last week.

And while the farmers are in the streets, wealthy individuals are in the air, winging their way to friendlier tax climes. Ms. Reeves's budget included the removal of a longtime exemption that allowed wealthy foreigners to shield overseas investment income from British taxes during their first several years of residence in the U.K., and their global estates from British inheritance taxes. She claims the move will raise an additional £12.7 billion over five years, but it's mainly a revenue generator for moving companies as news reports highlight an uptick in wealthy taxpayers fleeing Britain entirely.

For all this commotion, Ms. Reeves's revenue projections are likely to prove a bigger fiction than a Booker Prizewinning novel. Once the increased payroll tax has finished destroying jobs, employers will be paying the higher rate on fewer workers with lower earnings. Ebbing investment will mean reduced profits and lower corporate tax revenues, and less productivity growth to boost taxable wages. Fewer wealthy bankers means less income-tax revenue from their salaries and less valueadded tax from their consumption.

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Labour's pitch before the election and since, accepted without question by too many economic analysts and even some of the business groups now kvetching, is that what an economy needs most is stability. By this they mean government books that balance. This is the premise on which Ms. Reeves keeps trying to sell a painful tax-raising budget as a boon for economic growth.

Instead, the U.K. is all but certain to get less revenue, bigger budget deficits, and less prosperity.

Since it's unclear how much experience Ms. Reeves has as an economist, this is an opportunity to inform her of something called the Laffer Curve. Devised by economist and longtime contributor to these pages Art Laffer, this theory posits that as tax rates increase beyond a certain level, the taxes generate less revenue. High rates punish investment and work such that you get less of each, and a smaller tax base.

In response governments start creating exemptions, deductions and other carve-outs that allow individuals and companies to reduce their effective tax burdens—in ways that further distort investment. Ms. Reeves will make this mistake, too, if she starts offering "targeted" exceptions to groups that complain the loudest.

This budget mess is a bitter lesson in economics for Ms. Reeves and British voters alike. Especially so after the political class (both Labour and Conservative) rejected the supplyside alternative of former Prime Minister Liz Truss's tax reforms in autumn of 2022. Those policies were intended to boost economic growth and government revenues by shifting Britain onto a better segment of the Laffer Curve. Those reforms were derided at the time as a Laffer Curve fantasy. Britain now has a Laffer Curve nightmare instead.

By Joseph C. Sternberg

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